Global Economic & Markets Outlook

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Macquarie economists believe plans to release economies in shut-down will occur quickly. As a result, a meaningful economic recovery (from a low base) is likely to commence in Q3 as sectors currently locked down are gradually reopened.	The spectacular fall in activity seen in most of the non-China world in April/May is likely to be the low point, with global GDP expanding by ~6% in H2. Confidence in a recovery is supported by the "whatever it takes" approach from policy makers around the world.	Macquarie expect the Australian economy to fare a little better than many other economies in Q2 and over the rest of 2020 due to the domestic policy response being one of the largest in the world as a share of GDP as well as relatively better 'success' with respect to combatting the virus.

Macquarie's Global Economics team have updated their outlook and forecasts given the progress being made on containing Coronavirus and recent moves towards easing of lockdowns – "Global Economic and Markets Outlook - Looking beyond the unimaginable…". The following is a summary of their views.

A meaningful global recovery starting in Q3

Macquarie suspect plans to release the global economy will now occur quickly. This suggests that a meaningful economic recovery (from a low base) is likely to commence in Q3 as sectors currently locked down are gradually reopened.

The spectacular fall in activity seen in most of the non-China world in April/May is likely to be the low point, with global GDP expanding by around 6% in H2 (it's relatively easy to achieve a V-shaped recovery when the starting point is this low).

Global Economic Forecasts

	2019	2020	2021	2022
US	2.3	-4.3	3.3	3.0
China	6.1	1.4	8.1	5.0
Eurozone	1.2	-7.8	5.3	1.7
Japan	0.7	-5.3	3.3	1.5
India	5.1	0.5	9.4	6.1
UK	1.4	-6.0	4.2	2.0
Canada	1.6	-10.5	4.5	3.0
Australia	1.8	-3.3	4.4	3.4
New Zealand	2.3	-4.4	4.9	2.6
Global (MER)	2.6	-3.6	5.2	3.0
Global (PPP)	2.9	-2.7	5.6	3.3

Source: Macquarie Macro Strategy, April 2020

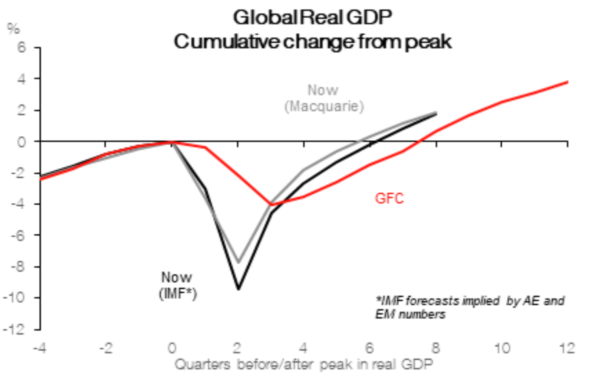
Global GDP should begin to recover in H2

Source: Macquarie Macro Strategy, April 2020

They believe a recovery is supported by the "whatever it takes" approach from policy makers around the world: in war time, deficits and monetary independence rightly take a back seat.

However, despite the relatively optimistic outlook, Macquarie does not expect the global economy to return to "normal" any time soon, with the level of global output at the end of 2020 still more than 4% below the previous trend. This is not unusual: historically it has taken years to recover after deep recessions.

The level of output will take some time to recover



Source: Macquarie Macro Strategy, April 2020

China: Sharp fall in 1Q with a recovery underway in 2Q

China is leading the rest of the world by two months, with the recovery in March providing comfort that even a modest relaxation of social distancing restrictions will see growth return.

February marked the lowest point with activity rebounding in March, thanks to the easing of lockdown, policy support and pent-up demand. Export growth was -6.8% yoy vs. -17.2% in Jan-Feb. Industrial production growth was -1.1% yoy vs. -13.5%. The surveyed unemployment rate also edged down to 5.9% vs. 6.2%. The recovery continued into April. Property and auto sales have almost recovered to the previous year's level.

Despite recent recovery, three economic risks loom ahead: 1) China's exports have plenty of room to fall in the coming months, due to weak global demand. 2) The property sector is another significant downside risk for the year as price momentum has worsened recently. 3) Deflation will intensify significantly on plunging oil prices as China's PPI is closely correlated with oil prices which look likely to remain weak.

Macquarie's China economist expects stimulus escalation later this year, mainly due to the coming surge in unemployment. Specifically, he estimates that 20m jobs could be lost, including 6m new jobs and 14m current jobs.

The US-China relationship is another concern. After COVID-19 is gone, a risk is a breakout of a new round of trade disputes between these two countries. Overall imports from the US are still lagging the targets set in the Phase One deal.

United States: A rebound in 2H, followed by a long grind

Macquarie's US economists expect US activity to decline significantly in 2Q amidst the widespread shutdowns that commenced in mid-March.

In their view, more important than estimating the magnitude of the decline is gauging the trajectory of the recovery. Their expectation is that real GDP will follow a "square root" type profile over the next 18-24 months. Following the sharp decline in 2Q, there should be a substantial rebound in 2H20, reflecting a gradual normalization process as activities are brought back online slowly. This should be supported by highly accommodative fiscal and monetary policy.

Subsequent to this, in 2021, a more modest pace of real GDP growth should unfold (they expect ~3 to 3.5% growth) as some of the more persistent scars from the virus and related shutdown become apparent. According to their baseline view, the 4Q19 level of real GDP is not surpassed until early 2022.

US policy and rates outlook

Macquarie believes the Federal Funds rate is likely to remain at the zero 'lower bound' for several years. Chair Powell indicated in a recent Q&A session that the Fed would be sure the economy is "really on solid footing" before it would pull back on its emergency measures and QE program. He also indicated any exit would be well telegraphed and occur only gradually.

Eurozone: Worse than the GFC, but recovery from Q3

Macquarie expects annualised GDP growth in Q1 and Q2 of -15% and -31%. However, while near term expectations have been significantly downgraded, the outlook over the 2H20 is now much stronger, reflecting a "V"-shaped recovery.

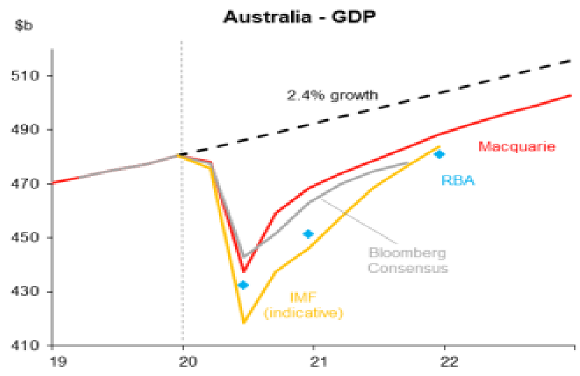
After the biggest downturn in living memory, Macquarie expects the lockdowns to be progressively lifted over coming months, with Germany, Austria, Norway and the Czech Republic already announcing initial easing. This should see growth return in Q3, with GDP increasing by around 7% in H2. While this implies a strong recovery, they do not expect the level of GDP to return to its previous peak until late 2022/early 2023.

Australia: Faring a little better, relatively

Following a modest decline in Q1 GDP, economic activity in Australia will fall sharply as the economy was put into hibernation from late March. While there has been significant fiscal and monetary policy support, this will only help to cushion the economic blow in the near-term. The unemployment rate will spike into the high single-digits and, more importantly, hours worked is expected to fall by at least 15% in Q2 Headline inflation will turn negative in Q2, largely due to free childcare and sharply lower petrol prices.

Macquarie's assessment, however, is that the decline in Q2 GDP may not be as bad as feared by the RBA and IMF and that economic conditions could improve a bit faster over the remainder of 2020.

Big fall in Q2 GDP followed by recovery



Source: Macquarie Macro Strategy, April 2020

Macquarie suspects that the Australian economy is going to fare a little better than many other economies in Q2 and over the rest of 2020. Why? First, they expect the Q2 decline in economic activity in Australia to be a bit less severe than in the US and Europe as the extent of the 'lockdown' appears less pronounced. Secondly, the estimated policy response in Australia – particularly government support measures – is one of the largest in the world as a share of GDP. Finally, the evidence so far points to relatively better 'success' with respect to combatting the virus itself, raising the prospects of a relatively earlier, and possibly faster, re-opening of the domestic economy.

The recovery in dwelling investment that was previously expected to start in H2 this year will be delayed. Rental markets are loosening quickly, and housing price growth has eased further. Macquarie expects only modest housing price declines at the national level of up to ~5% due to the significant policy response, particularly the ability to defer mortgage repayments for six months.

Australian Economic Forecasts

		2019	2020	2021	2022
GDP	y/y	1.8	-3.3	4.4	3.4
CPI	y/y	1.6	0.5	1.6	1.8
Core CPI	y/y	1.4	1.3	1.4	1.8
A$/US$		0.70	0.65	0.67	0.68
RBA cash rate	%	0.75	0.25	0.25	0.25
3-yr yield	%	0.90	0.26	0.26	0.40
10-yr yield	%	1.37	0.90	1.10	1.40

Source: Macquarie Macro Strategy, April 2020

Australian rates outlook

The RBA cash rate will be anchored at 0.25% for the next few years. The RBA's 0.25% target for the 3-year yield is also likely to be in place for a large part of that period. Combined with Macquarie's view that US 10-year yields will remain below 1% until end-2021 and inflation remaining below the RBA's 2-3% target for the foreseeable future, Australian 10-year yields are likely to remain at very low levels for a long time.

FX outlook: US dollar ascendant

Macquarie expect the US Dollar to hold on to its recent gains, for the coming months at least. Lockdowns are being slowly lifted, but COVID-19 should remain a drag on global economic activity afterwards, especially if infections pick up again. So residual risk-aversion is likely to linger, in the absence of game-changing medical advances. For USD selling to develop, the US presidential election in November may need to get much closer.

The AUD is currently hostage to concerns about global growth. Even Australia's economic dataflow is of little consequence for now. If a second wave of virus infections hits, global growth will recede again, dragging the AUDUSD down. Nevertheless, Macquarie temper their previous AUD bearishness in light of the Fed's rapid and surprisingly aggressive policy response which has lent badly needed support to US credit markets. The result is that a biological shock is less likely to develop into a serious financial stability shock too.

Jason and the Investment Strategy Team

The report was finalised on 30 April 2020

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